

# Impact Investment

## A Financial Solution to Fund Cities: North America



*"This has a political appeal because it's both **socially progressive** and **fiscally conservative**. That's a real winner." (George Overholser, Founder of Third Sector Capital Partners)*

Impact investment, in the largest sense of the term, is a sort of "pay-for-success" approach to social spending. Impact investment programs and projects take social issues that cost local and state governments money and outsource the solution to the private/non-governmental sector. The public sector **only pays if the measurable impact is positive**, that is, if the program/project is deemed a success and saves the government money. Appropriate interventions would be capable of proving their success with data, benefitting the community more so than existing programs, and introduce a scalable and replicable model. The most wide-spread and talked about tool of impact investment for local governments are social impact bonds (SIBs). There are currently **14 SIBs** developing in the United Kingdom, where they were created by the non-profit Social Finance U.K.. In the U.S., the

model remains limited to the NYC Riker's Island project, two Social Innovation Financing programs in Massachusetts, and a Human Capital Performance Bond (HuCap) being piloted by Minnesota. Harvard's JFK School of Government has recently launched a Social Impact Bond Lab to which a further **28 local governments** applied to receive technical assistance in piloting SIBs in their communities.

### What are the advantages?

One of social impact bonds main advantages is offering a way of **financing preventative social programs** for which states and local governments are hard-pressed to garner support. SIBs also **shelter tax payers** from paying for programs that don't have a considerable effect on the community.

### What are the main challenges?

Impact bond critics point to the mechanism as **another form of government privatization**. The bonds also involve rather high equity risk for investors in this nascent phase. SIBs are not appropriate in all social program contexts. The problem being addressed, for example, should prove that it is even able to benefit from an intervention.

#### **Case Study:** Riker's Island Project

**Location:** New York City, NY

**Investor:** Goldman Sachs

**Backing:** Bloomberg Philanthropies

NYC is the first city in the U.S. to implement the social impact bond on a project to reduce recidivism amongst teen prisoners on Riker's Island. Goldman Sachs provided the \$9.6 million loan while Bloomberg Philanthropies offered a \$7 million backing. The money will fund the intervention of MDRC, a education and social policy non-profit created by the Ford Foundation in the 1970s, while the Vera Institute for Justice will undertake the evaluation of the project. MDRC is working with the New York City Mayor's Office, the Department of Correction (DOC), The Osborne Association, and Friends of Island Academy to implement the project. The program will take the form of cognitive behavioral therapy for 16 to 18 year olds focusing on personal responsibility, education, training and counseling. Success is set to be measured by MDRC's capacity to cut the recidivism rate by 10%, offering enormous public savings in policing, court proceedings and incarceration. If the rate is cut by more than 10%, the investor (Goldman Sachs) can turn a profit of up to 21%. If the goal is not met or falls short, Bloomberg Philanthropies will bear the brunt of the loss having guaranteed a little over 75% of the investment. This innovative partnership of public, private, and non-profit stakeholders is likely to see many replications if the Riker's Island project proves a success.

### Who is involved with Social Impact Bonds in the United States ?

Rockefeller Foundation

Harvard University John F. Kennedy School of Government

Social Finance U.S. (Boston)

Non-Profit Finance Fund (New York)

Clinton Global Initiative

Bloomberg Philanthropies

White House Office of Social Innovation and Civic Participation

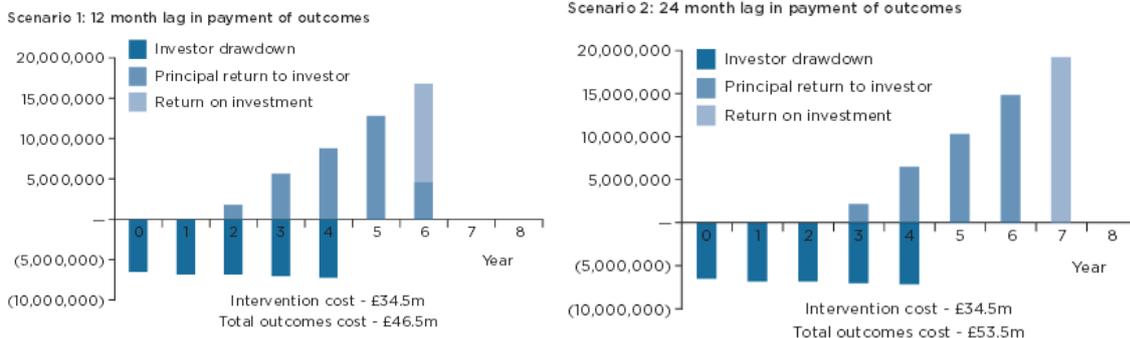
NGOs: Twin Cities RISE!, Third Sector Capital Partners, Massachusetts Housing and Shelter Alliance, Roca Inc., as well as those mentioned in the case study.

### Development Impact Bonds

While they don't yet exist, development impact bonds (DIBs) are gaining a lot of attention as a new business model made possible by a new way of financing. The main difference between social impact bonds and development impact bonds is who pays back the investor. In the first case, it is governments. In the latter case, the interest paid back to investors if the project succeeds falls on international donors, development agencies, or foundations participating in the DIB. In addition, DIBs attempt to **increase the effectiveness** of traditional donor-funded development projects. Like social impact bonds, DIBs shift focus to the **quality of implementation** and the **success of results**. The work and debate on potential DIBs currently centers on working with national governments, but could one day be appropriated and applied by local authorities as well to

serve as a platform for multi-sector coordination. □  
development cooperation and

FIGURE 7. ILLUSTRATIVE PAYMENTS TO INVESTORS BASED ON 12 MONTH LAG AND 24 MONTH LAG IN OUTCOME PAYMENTS



(Center for Global Development and Social Finance 2013)

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## REolutions to Fund Cities

This “Economic Solution” has been produced within the context of FMDV's **REolutions** program. REolutions, a four-year international program, offers an invitation to all urban actors to **Rethink Economic solutions** that operationalize sustainable, efficient, and resilient local development.

Initiated by a consortium of local authority networks, REolutions concentrates on identifying, analyzing, transferring and pilot-implementing economic and financial strategies and mechanisms that have improved the impact and performance of local urban development policies.

Anchored and articulated at the regional level in a multi-actor setting, REolutions seeks to equip local authorities with the tools to integrate and operationalize a wide variety of financial resources for the endogenous development of their cities.

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